



Office of the Attorney General  
State of Texas

DAN MORALES  
ATTORNEY GENERAL

February 20, 1996

Ms. Rita Horwitz  
Executive Director  
State Pension Review Board  
P.O. Box 13498  
Austin, Texas 78711-3498

Letter Opinion No. 96-013

Re: Whether the state treasury is prohibited by statute or constitutional provision from purchasing any security priced above market value and whether the state is prohibited from guaranteeing the investments of other governmental subdivisions (ID# 30971)

Dear Ms. Horwitz:

You ask whether "the state Treasury is prohibited by statute or constitutional provision from . . . [purchasing] any security priced above market value" and whether "there is any legal provision that enjoins the state from guaranteeing the investments of other governmental subdivisions." The state auditor has also expressed an interest in these questions.<sup>1</sup>

Your questions arise from events involving the Texas Local Government Investment Pool ("TexPool") in December 1994, and our answers will be limited to the state treasurer's actions with respect to TexPool securities at that time. TexPool is a public funds investment pool for local governments established by the Texas Treasury Safekeeping Trust Company (the "trust company"). The state treasurer is authorized to establish the trust company by chapter 404, subchapter G of the Government Code<sup>2</sup> "to obtain direct access to services provided by the Federal Reserve System and to enable the treasurer to manage, disburse, transfer, safekeep, and invest funds and securities more efficiently and economically." Gov't Code § 404.102(a). Although the trust company may not engage in commercial banking activity, *see id.* § 404.102(b), the trust company may

receive, transfer, and disburse money and securities as provided by statute or belonging to the state, agencies and local political subdivisions of the state, and nonprofit corporations, foundations, and other charitable organizations created on behalf of the state or an

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<sup>1</sup>This office has requested the state treasurer to provide a brief regarding the legal issues raised by this request. To date, we have not received a brief from the state treasurer.

<sup>2</sup>All references to the Government Code are to provisions in effect in December 1994.

agency or local political subdivision of the state in a manner that qualifies the trust company for federal reserve services.

*Id.* § 404.103(a); *see also id.* § 404.106(b) (investment of trust company funds). The state treasurer is the sole officer, director, and shareholder of the trust company; the state treasury manages the trust company. *Id.* § 404.104(a). TexPool is a distinct trust fund held outside the state treasury. TexPool Participation Agreement art. II, § 2.02. The state treasurer serves as a trustee of the fund. *Id.*

In December 1994, there was concern nationwide regarding the integrity of public investments as a result of investment losses in a pooled fund managed by Orange County, California. A number of TexPool participants withdrew their funds in what was referred to as a “run” on the pool. In response, the state treasurer used funds in the state treasury to purchase securities in TexPool’s portfolio at a price above market value. We understand that in order to generate cash to do so, the state treasurer sold securities from the state treasury’s portfolio at a loss.

With respect to your first question, it has been suggested that the state treasurer’s use of funds in the state treasury to purchase TexPool securities at a price above market value was improper for the following reasons: first, that it was inconsistent with the state treasurer’s duty to invest funds held in the state treasury; and second, that the state treasurer’s actions constituted an unauthorized withdrawal from the state treasury contrary to the Texas Constitution. We examine these two contentions in turn.

The state treasurer’s authority with respect to funds in the state treasury is governed by chapter 404 of the Government Code. The state treasurer is the trustee of funds in the state treasury. Gov’t Code § 404.041. Generally, subchapter C of chapter 404, sections 404.021 through 404.027, authorizes the state treasurer to deposit or invest funds in the state treasury. Section 404.024 provides that state funds not deposited in state depositories shall be invested by the state treasurer in certain statutorily authorized investments. *See id.* § 404.024(b); *see also id.* § 404.0245 (authorizing investment of state funds in certain futures contracts).<sup>3</sup>

Chapter 404 of the Government Code does not define the terms “invest” and “investment.” We construe them according to their common meaning. *Id.* § 311.011(a) (rule of code construction). To “invest” means to loan or place money “so that it may produce revenue or income”; an “investment” is the “placing of capital . . . in a way intended to secure income or profit from its employment.” BLACK’S LAW DICTIONARY

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<sup>3</sup>Other provisions of chapter 404 of the Government Code authorize the state treasurer to engage in other transactions for limited purposes and are not applicable here. *See, e.g.,* Gov’t Code §§ 404.024(k) (now Gov’t Code § 404.024(i)) (authorizing state treasurer to purchase commercial paper in certain circumstances), .027 (providing that state treasurer may enter into certain credit agreements), .121 - .126 (providing for issuance of tax and revenue notes in case of cash shortfall).

960 (rev. 4th ed. 1968). Section 404.024(b) authorizes the state treasurer to invest funds in the state treasury in certain securities. Ordinarily, the purchase of authorized securities would constitute an investment. The state treasurer's use of funds in the state treasury to purchase TexPool securities at a price above market value under these circumstances, however, does not appear to have been undertaken for investment purposes, but for the purpose of preventing losses to TexPool. We have not been able to locate a statute which permits the state treasurer to use unappropriated funds in the state treasury for a purpose other than those delineated in chapter 404. We conclude that the state treasurer's decision to use funds in the state treasury to purchase TexPool securities at a price above market value was inconsistent with the state treasurer's authority with respect to funds held in the state treasury.

We next consider whether the use of funds in the state treasury to purchase TexPool's securities at above market value constituted the withdrawal of funds from the state treasury in the absence of a legislative appropriation. Article VIII, section 6 of the Texas Constitution provides in part: "No money shall be drawn from the Treasury but in pursuance of specific appropriations made by law . . . ."

When the state treasury bought TexPool securities at a premium above market value for the purpose of preventing losses to TexPool, there was a transfer of state funds to TexPool in the amount of the premium. As we have already stated, TexPool is held outside of the state treasury. Pursuant to article VIII, section 6 of the Texas Constitution, funds may be drawn from the state treasury only pursuant to an appropriation enacted by the legislature.<sup>4</sup> Even in a situation in which funds were erroneously deposited in the state treasury, the funds could not then be withdrawn from the state treasury in the absence of a legislative appropriation. *Manion v. Lockhart*, 114 S.W.2d 216, 219 (Tex. 1938); Attorney General Opinions C-742 (1966), O-44 (1939). We conclude that the transfer of funds to TexPool in excess of the market price of the securities constituted the withdrawal of funds from the state treasury without an appropriation, in violation of article VIII, section 6 of the Texas Constitution.

Moreover, we question whether the legislature would have had authority to appropriate funds to TexPool for the purpose of preventing losses to its investors. Article III, section 44 of the Texas Constitution provides that the legislature shall not "grant, by appropriation or otherwise, any amount of money out of the Treasury of the State, to any individual, on a claim, real or pretended, when the same shall not have been provided for by pre-existing law." See *Austin Nat'l Bank v. Sheppard*, 71 S.W.2d 242 (Tex. 1934); Attorney General Opinion JM-1181 (1990). As we will discuss below in connection with section 404.103(b) of the Government Code and the TexPool Participation Agreement, the state had not guaranteed the trust company's obligations to TexPool. Accordingly, we

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<sup>4</sup>A constitutional provision may of course appropriate funds. See Tex. Const. art. VII, § 17.

find no pre-existing law that would have supported a legislative appropriation to cover losses to TexPool investors.

You also ask whether any law prevented the state from guaranteeing the investments of political subdivisions in TexPool. Section 404.103(b) of the Government Code, which authorizes the trust company to enter into contracts and trust agreements with the state treasurer, the Federal Reserve System, and other third parties, provides as follows:

The trust company shall be liable under those contracts *in accordance with the terms contained in the contracts*. Notwithstanding any other statute to the contrary, *to the extent permitted by the Texas Constitution and the contracts*, trust agreements, or other fiduciary instruments between the trust company and the Federal Reserve System, the trust company's obligations shall be guaranteed by the state . . . . [Emphasis added.]

Thus, the terms of the contracts control the liability of the trust company to other parties. The TexPool Participation Agreement provides that all earnings and losses on investments shall be allocated on a pro rata basis among TexPool participants. TexPool Participation Agreement art. IV, § 4.03; *see also id.* art. VII, § 7.02 (“[N]either the Treasurer nor the Trust Company shall be liable for any losses from investments and transfers made in accordance with the procedures set forth in this Participation Agreement.”). Accordingly, pursuant to the TexPool Participation Agreement in effect in December, 1994, the trust company's obligations to TexPool participants were not guaranteed by the state. Thus, we conclude that section 404.103(b) of the Government Code together with the TexPool Participation Agreement prevented the state from guaranteeing the investments of political subdivisions in TexPool.

Finally, we close with the following observations in order to provide a framework for these conclusions. First, the office of the state treasurer will cease to exist effective September 1, 1996. Moreover, when the legislature met in January 1995, it was fully aware of the actions taken by the state treasurer in December 1994 with respect to TexPool and the context in which those actions were taken. The legislature responded by passing House Bill 2459, which significantly changed and restricted the way in which public funds in Texas may be invested. *See* Act of May 18, 1995, 74th Leg., R.S., ch. 402, § 1, 1995 Tex. Sess. Law Serv. 2958, 2958-69 (amending Public Funds Investment Act) (effective September 1, 1995).

**S U M M A R Y**

The state treasurer's use of funds in the state treasury in December 1994 to purchase TexPool funds at a price above market value was not authorized by law.

Yours very truly,

A handwritten signature in cursive script that reads "Susan L. Garrison".

Susan L. Garrison  
Assistant Attorney General  
Opinion Committee